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No. 06-1413

# In the Supreme Court of the United States

THE MEADWESTVACO CORPORATION, SUCCESSOR IN INTEREST TO THE MEAD CORPORATION, PETITIONER,

v.

ILLINOIS DEPARTMENT OF REVENUE, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, AND TREASURER OF THE STATE OF ILLINOIS, RESPONDENTS.

**On Petition for Writ of Certiorari to the Appellate Court of Illinois**

## BRIEF IN OPPOSITION

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## QUESTION PRESENTED

The Due Process and Commerce Clauses permit a State to tax a fraction of the income earned by a nondomiciliary corporation from a capital transaction that served an operational function for the business and did not arise from a mere passive investment. *See Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 785, 787 (1992); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 180 n.19 (1983). The Illinois Appellate Court applied this fact-intensive "operational function" test to allow Illinois to tax a portion of the gain realized from Petitioner's sale of its Lexis/Nexis division—whose growth Petitioner nurtured from its inception through both management expertise and capital contributions, repeatedly restructured for its own tax benefit, and held out to the government, its own shareholders, and the general public as part of its general business operations. Does the appellate court's application of this "operational function test" in this case conflict with this Court's precedent or other state high-court decisions, warranting the exercise of this Court's discretionary review?

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## BRIEF IN OPPOSITION

## STATEMENT

### 1. The Tax Dispute

A. Petitioner misstates or omits many of the crucial facts of this case, beginning with its assertion in the Question Presented that Lexis/Nexis operated as an independent, nonunitary business of Petitioner for 26 years. In fact, for the tax year in question, and for the previous five years, Petitioner treated Lexis/Nexis as a part of its unitary business group for the purpose of Illinois income tax filings and payments. It was not until Petitioner realized the gain from Lexis/Nexis's sale that Petitioner altered its position and began to claim that Lexis/Nexis was not part of its unitary business group.

From 1988 to 1993, Mead reported over $3.8 billion in income, of which over $800 million was from Lexis/Nexis, on its Illinois combined income tax returns. Vol. 4, C842.[1] Over these years, Petitioner also reported over $4.4 billion in business expense deductions on its Illinois combined income tax returns, of which over $680 million was attributable to Lexis/Nexis. *Id.* In 1994, Petitioner reported Illinois sales of over $338 million, of which almost $47 million was contributed by Lexis/Nexis. Pet. App. 4a.

B. Petitioner's relationship with Lexis/Nexis, however, began 26 years before the 1994 tax year. *Id.* at 2a. In 1968,

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[1] Citations to the record on appeal will be by volume number and page. The common law record is designated with the prefix "C," i.e., Vol. ___, C___, and the report of proceedings with the prefix "RP," i.e., Vol. ____, RP ___.

Petitioner purchased Data Corporation for $6 million. *Id.* At the time, Data Corporation was developing ink jet printing technologies and a full text information retrieval system for computers. *Id.* By 1973, the information retrieval system had become Lexis/Nexis. *Id.* But Lexis/Nexis did not become profitable until the end of the 1970s; until then it was supported by Petitioner's capital contributions. *Id.*; *see also* Vol. 9, RP 68, 92.

Throughout the 1980s and 1990s, Petitioner continued to approve major capital expenditures for Lexis/Nexis to expand its computer center and central processing units. Pet. App. 3a. In the 1980s, impressed by its strong position in electronic publishing, Petitioner rejected a plan to sell Lexis/Nexis, and instead "encouraged management to continue to develop growth plans for this division." Vol. 7, C1502.

Also, in the 1980s and 1990s, Petitioner treated Lexis/Nexis alternatively as a corporate division or a corporate subsidiary. Pet. App. 2a. In 1980, Lexis/Nexis was merged into Petitioner as a division; in 1985, it was reincorporated separately; in December 1993, it was merged again. *Id.* at 2a-3a. Petitioner undertook the mergers in order to realize substantial tax savings, in the last case by permitting Petitioner to utilize operating loss carry forwards that otherwise would have expired. *Id.* at 13a; Vol. 7, C1741; Vol. 8, C1753.

C. In its 1993 annual report, Petitioner touted itself not only as "'one of the world's largest manufacturers of paper,' and a leader in packaging" but also as "'the developer of the word's leading electronic information retrieval services for law, patents, accounting, finance, news and business information.'" Pet. App. 3a. On its 1993 10-K form, filed with the Securities and Exchange Commission, Petitioner likewise described itself as engaged in the business of electronic publishing. Pet. App.

4a; Vol. 6, C1330. Consistent with this pronouncement, the 10-K filing listed Lexis/Nexis among Petitioner 's "business segments," rather than among its 'investees.' Pet. App. 3a-4a. Petitioner also listed "LEXIS" and "NEXIS" as trademarks under which it "conducts its business" and which were "of material importance to [its] business." Vol. 6, C1334.

When it announced plans to sell Lexis/Nexis, Petitioner stated in a press release that it had "'grown'" Lexis/Nexis from its inception as a "'small legal data-base into the word's premier provider of online legal information and the pioneer in computer-assisted news retrieval.'" Pet. App. 4a. (quoting Vol. 4, C930). In describing the sale in its 1994 annual report, Petitioner again emphasized that it had "'grown[n] this business'" and decided to use much of the gain realized on Lexis/Nexis's sale to, *inter alia*, buy back stock.[2] *Id.* (quoting Vol. 6, C1277).

D. Petitioner and Lexis/Nexis's day-to-day business operations were separate in some respects. *Id.* at 3a. Since 1980, Petitioner and Lexis/Nexis had been housed in buildings 15 miles apart. *Id.* They did not share personnel, purchasing functions, manufacturing or warehousing, they were described as having separate corporate cultures, and there were no favorable intercompany transactions. *Id.* But Petitioner did make a nightly cash sweep of Lexis/Nexis's bank accounts, and Petitioner invested the money for Lexis/Nexis's benefit "in a manner decided by" Petitioner. *Id.*

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[2] There is a typographical error in the Illinois Appellate Court's decision, immaterial to the present case. The decision states that $350,000 of the gain was used to buy back stock (Pet. App. 4a); in fact, the amount was about $350 million, and an additional $725 million of the gain was used to reduce corporate debt (Vol. 4, C842).

## 2. Proceedings Below

Respondent Illinois Department of Revenue, made two audit findings adverse to Petitioner for the 1994 tax year: that Petitioner 1) improperly classified the gain from the sale of Lexis/Nexis as income not subject to apportionment by the State and therefore not subject to Illinois income tax (even in part), and 2) improperly included almost $5 billion in gross receipts on the sale of short-term financial instruments in its sales factor denominator, rather than the $1.9 million of actual interest income. Pet. App. at 5a. The trial court affirmed the auditor's finding against Petitioner on the second issue on summary judgment, and Petitioner's challenge to the first finding proceeded to a bench trial. Pet. App. 5a-6a.

The trial court considered stipulated facts and heard testimony. Petitioner retained three tax law professors to testify as expert witnesses on the question of income apportionability: Richard Pomp, Walter Hellerstein, and Ferdinand Schoettle. Pet. App. 30a-31a, 48a-103a. Over Respondent's objection, the trial court allowed the testimony "for the [witnesses] opinions," but the court would not accept the "bases for the opinions" as substantive evidence. *Id.* at 34a. Nevertheless, the professors opined as to their view of the appropriate legal standard, applied the facts to that standard, and concluded that under their standard Lexis/Nexis was neither unitary with Petitioner, nor an operational asset. *See* Vol. 9, RP 124-57, 165-92, 205-19.

The Illinois Department of Revenue's auditor also testified on income apportionment (Pet. App. 31a), although Petitioner misstates his testimony. Petitioner states that the auditor testified that "there was no functional integration between Petitioner and Lexis/Nexis, *nor was there any operational relationship between the businesses.*" Pet. 8 (emphasis in original). In fact, the auditor specifically denied Petitioner's

assertions that he never found functional integration, centralized management or economies of scale. Vol. 10, RP 10-11. And on the operational relationship question, the auditor testified only that Lexis/Nexis was not acquired in order to supply necessary raw materials as part of Petitioner's supply chain. *Id.* He did not testify that there was no operational relationship between the two companies. *Id.*

Based on the stipulated facts and the testimony, the trial court found that "it was not clear that there was no operational purpose" to Lexis/Nexis. Pet. App. 38a-39a. Accordingly, the trial court upheld Respondent Department of Revenue's conclusion that the gain realized on Lexis/Nexis's sale was apportionable business income subject to Illinois income tax. *Id.* at 6a. The appellate court affirmed in an unpublished, nonprecedential order. Pet. App. 12a-14a, 43a. In addition to affirming the trial court's ruling that the gain was constitutionally apportionable, the appellate court also affirmed the trial court's findings that the gain was business income under Illinois law, and that Petitioner could not, under Illinois law, use its total gross receipts from the sale of short-term financial instruments to reduce its Illinois apportionable income. *Id.* at 1a-22a.

Respondents successfully moved to publish the appellate court's decision because all of the decision's holdings are important—not just the court's ruling on the constitutionality of apportionment. *Id.* at 42a-47a. In the motion, Respondents pointed out that the appellate court's rulings on the state law sales factor issue and business income issue could potentially impact over a dozen pending lawsuits. *Id.* at 44a, 46a-47a. In contrast, the constitutional apportionment issue was important because the present case provided a useful counterpoint to an earlier appellate court decision, *Hercules, Inc. v. Dep't of Revenue*, 753 N.E.2d 418 (Ill. App. Ct. 2001), which, on a

different set of facts, held that the gain from the sale of a capital asset was not constitutionally apportionable under the operational function test. Pet. App. 44a-45a.

## REASONS FOR DENYING THE PETITION

The petition does not satisfy this Court's criteria for issuing a writ of certiorari. *See* Sup. Ct. R. 10. Petitioner has not identified a conflict with this Court's decisions establishing the operational function test. The appellate court relied on the legal standard articulated in *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992), which all agree provides the proper constitutional test. *See* Pet. App. 11a (stating that "the relevant inquiry under the operational function test focuses on the "'objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State'") (quoting *Allied-Signal*, 504 U.S. at 785); Pet. 2, 12 (citing *Allied-Signal*). Petitioner 's only real criticism of the appellate court's decision is that it misapplied the proper standard to the facts of this case.

Nor is the appellate court's decision in conflict with decisions from high courts of other States. This Court has noted that the constitutional question of income apportionment is "quite fact sensitive," which by its nature allows courts "to reach[] divergent results" in "different factual circumstances." *Allied-Signal*, 504 U.S. at 785. Other state courts have also recognized the fact-intensive nature of the operational function test, and have applied it with results that vary with the facts of each case. This is not a conflict; it is the inevitable result of applying a fact-sensitive rule to factually distinct transactions.

## I. The Illinois Appellate Court's Decision Does Not Conflict with this Court's Decisions Establishing and Applying the Operational Function Test.

This Court has held that the Due Process and Commerce Clauses of the Federal Constitution prevent States from taxing extraterritorial values earned by nondomiciliary corporations. *See ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982); *see also Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165-66 (1983). In order to apportion multistate income earned by a nondomiciliary corporation, there must be some rational relationship between the "opportunities, benefits, or protection conferred or afforded by the taxing State," and the activities that the State seeks to tax. *See F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354, 371-72 (1982) (quotations omitted); *see also Allied-Signal*, 504 U.S. at 772. To exclude income from state tax apportionment, the taxpayer has "the distinct burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed." *Container Corp.*, 463 U.S. at 164 (punctuation omitted); *see also Allied-Signal*, 504 U.S. at 787 (stating that taxpayer must prove "that the income was earned in the course of activities unrelated to those carried out in the taxing State") (punctuation omitted).

A nondomicilliary business's multistate income may be constitutionally apportioned if the multistate operation is run as a single unitary business or if the asset or transaction a State seeks to tax served an operational function. *See Allied-Signal*, 504 U.S. at 783, 787. This latter, operational function test "focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." *Id.* at 785 (citing *Container Corp.*, 463 U.S. at 180 n.19); *see also id.* at 787. A State may not constitutionally apportion income earned by a mere passive investment in another State.

*Allied-Signal*, 504 U.S. at 788. Unlike a passive investment, an operational relationship provides the necessary link between the State and the activity the State seeks to tax sufficient to satisfy due process and the Commerce Clause. *Id.* at 785, 787-88.

In distinguishing between an operationally related asset and a passive investment, this Court has looked for objective evidence of management's role in ensuring the particular asset's growth and at the asset's role in the taxpayer's business operations in the taxing State. *See id.* at 789; *Container Corp.*, 463 U.S. at 180 n.19; *see also ASARCO*, 458 U.S. at 323. While recognizing that the distinction is "quite fact sensitive," *Allied-Signal*, 504 U.S. at 785, this Court has provided some nonexclusive illustrations of multistate business investments that serve an operational function: 1) income earned on short-term investments used to provide working capital, *see id.* at 787-88; *ASARCO*, 458 U.S. at 325 n.21; and 2) income on investments designed to provide a stable supply of a key ingredient, *see Allied-Signal*, 504 U.S. at 788 (citing *Corn Prods. Refining Co. v. Comm'r*, 350 U.S. 46, 50-53 (1955)). This Court has also described one fact pattern where an investment does not serve an operational purpose: a passive investment acquired pursuant to a long-term strategy of corporate acquisitions and divestitures. *Allied-Signal*, 504 U.S. at 788.

Again, given the fact-intensive nature of the inquiry, nothing in *Allied-Signal* suggests that these examples are exclusive, as Petitioner implies. *See* Pet. 12-13, 16, 19. Moreover, neither *Allied-Signal* nor prior decisions provide specific criteria to consider under the operational function test. (A point on which Petitioner's *amicus*, Council on State Taxation, agrees (*see* COST Br. at 4-5) but that Petitioner fails to acknowledge.) Certainly, nothing in *Allied-Signal* supports Petitioner and its *amicus*'s assertion that "the focal point" of the Court's analysis is "whether the asset was utilized directly in the selling

company's business."[3] Pet. 12-13, COST Br. at 5. Rather, the focus of the apportionment inquiry remains the flow of value between the business units and management's role in the business unit's affairs. *See Container Corp.*, 463 U.S. at 180 n.19; *accord Allied-Signal*, 504 U.S. at 788.

In deciding whether income is apportionable, this Court has considered facts such as the degree and exercise of actual control by the taxpayer over the business asset in question. *See, e.g.*, *Allied-Signal*, 504 U.S. at 788 (noting that 20.6% ownership interest was not enough even for potential control, which weighed against apportionment); *Container Corp.*, 463 U.S. at 177 n.16 (noting that potential control is not dispositive but is relevant to apportionment determination, distinguishing *Woolworth*, 458 U.S. at 362, which held that mere potential to control business affiliate was not dispositive as to whether affiliate's income was apportionable); *ASARCO*, 458 U.S. at 322-23 (unasserted majority interest weighed against finding that related businesses were unitary). The source of the business unit's financing is also relevant to the apportionment determination. *See Woolworth*, 458 U.S. at 366 (fact that each subsidiary was responsible for obtaining its own financing

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[3] The "utilized directly in the selling company's business" standard that Petitioner would impose lends itself to circularity. Petitioner assumes that it was not in the electronic publishing or electronic information retrieval business in order to argue that the facts that the appellate court relied on were irrelevant and that Lexis/Nexis was not an operational asset of its business. *See* Pet. 3-5. Under this Court's precedent, however, the facts define the scope of the business; the scope of the business is not predetermined in a manner that controls which facts are relevant. *See Mobil Oil Co. v. Comm'r of Taxes*, 445 U.S. 425, 440-42 (1980); *Exxon Corp. v. Wis. Dep't of Revenue*, 447 U.S. 207, 223-24 (1980).

weighed against finding that out-of-state affiliate's income was apportionable). Public statements of corporate purpose or intent, on which investors may rely, are also material. *See Container Corp.*, 463 U.S. at 180 n.19 (noting that evidence of managerial role in subsidiaries' business was found in taxpayer's statements in annual reports).

As other decisions of the Illinois Appellate Court applying *Allied-Signal* illustrate, these factors sometimes favor a holding for the multistate taxpayer. *See Home Interiors & Gifts, Inc. v. Dep't of Revenue*, 741 N.E.2d 998, 1004-05 (Ill. App. Ct. 2000) (relying on financial statements reporting that certain accounts were "investments" in analyzing whether income was apportionable); *Hercules, Inc. v. Dep't of Revenue*, 753 N.E.2d 418, 426-27 (Ill. App. Ct. 2001) (considering inability to control joint-venture as factor weighing against finding of operational relationship). Petitioner does not dispute that *Allied-Signal* articulated the operational function standard (Pet. 12, 19), and cannot dispute that the appellate court expressly applied *Allied-Signal*, Pet. App. 11a (stating that "the relevant inquiry under the operational function test focuses on the '"objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State'") (quoting *Allied-Signal*, 504 U.S. at 785), just as it did in *Hercules* and *Home Interiors & Gifts*. In this case, the appellate court simply concluded that, under *Allied-Signal*, Petitioner did not prove by clear and cogent evidence that the taxing authority had overreached the constitutional boundaries.

The appellate court weighed evidence showing the extent of Petitioner's actual exercise of control over Lexis/Nexis and its exercise of discretion to finance and control Lexis/Nexis's growth. Pet. App. 12a-14a. The court also relied on evidence of Petitioner's use of Lexis/Nexis to take advantage of net loss carry forwards that it could not otherwise obtain, as well as

evidence that Petitioner held itself out to financial regulators, shareholders and potential investors as engaged in the business of electronic publishing and electronic information retrieval, and that it considered its trademarks in Lexis/Nexis to be material business assets. *Id.* at 13a. No such evidence was present in *Allied-Signal*, or in cases like *ASARCO*, or *Woolworth*, where this Court found that income was not apportionable.

The appellate court's decision that under these facts Petitioner failed to prove by clear and cogent evidence that Lexis/Nexis was *not* an operational asset is thus perfectly consistent with this Court's holdings. Petitioner and its *amici* can only manufacture a conflict by mischaracterizing the appellate court's decision. Contrary to Petitioner's claim (Pet. 13, 15), the court did not rely solely on the fact that Lexis/Nexis was 100% owned by Petitioner (*see* Pet. App. 12a-13a) (reciting evidence used to conclude that Petitioner failed to meet its burden of proof). Nor are ownership percentages immaterial, as *amicus* COST claims. COST Br. at 6. In *Woolworth*, this Court held only that the potential for control was not dispositive, *see* 468 U.S. at 362, and in *Container Corp.* this Court clarified that such evidence was indeed relevant, *see* 463 U.S. at 177 n.16.

Nor was it improper for the appellate court to consider Petitioner's 10-K filings and the manner in which Petitioner held itself out to the public, investors and government regulators. *See id.* at 180 n.19 (evidence of management's role taken from annual reports). *Amicus* Gannett provides an extended discussion of what it means to include a company as a business segment on a 10-K statement, arguing that such inclusion is governed by independent Financial Accounting Standard No. 131. Gannett Br. at 6-7. Petitioner had every opportunity to make this argument before the appellate court but failed to do so,

meaning that this line of argument is forfeited.[4] *See Illinois v. McArthur*, 531 U.S. 326, 334-35 (2001). Moreover, nothing in *amicus* Gannett's discussion suggests that Petitioner 's choice between characterizing Lexis/Nexis on its 10-K statement as a business segment rather than as an investment, or its treatment of Lexis/Nexis trademarks as material to its business was meaningless. (At a minimum, potential investors should be able to rely on the fact that when a public corporation states that it is in the electronic publishing business, it means what it says.) Gannett's real objection is to the manner in which the appellate court weighed this evidence.

*Amicus* Gannett also mischaracterizes the record in arguing that Petitioner's nightly cash sweep amounted to a "constructive dividend" of Lexis/Nexis's earnings, which cannot be used as a basis for apportionment without undermining the "'unitary-business limitation.'" Gannett Br. at 6 (quoting *Woolworth*, 458 U.S. at 364 n.11). From December 1993 through Lexis/Nexis's 1994 sale, it was Petitioner's division, not its corporate subsidiary—and the 1994 sale was an asset sale, not a stock sale. Pet. App. 3a-4a. It is difficult to see how, and Gannett has cited no authority that, a cash sweep of a corporate division's earnings can be construed as a dividend, constructive or otherwise.

Further, when Lexis/Nexis was a corporate subsidiary, the cash yielded nightly from the sweep of Lexis/Nexis's bank accounts was invested for Lexis/Nexis's benefit, but at Petitioner's direction. *Id.* at 3a. Thus, on this record, Gannett's

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[4] The appellate court noted that Petitioner failed to provide "relevant legal authority" to support its argument that the trial court improperly considered the annual reports and 10-K statements. Pet. App. 13a. Petitioner therefore forfeited these arguments as a matter of Illinois law. *See People v. Ward*, 215 Ill. 2d 317, 332 (2005); Ill. Sup. Ct. Rule 341(h)(7).

contention that funds were commingled and that the cash sweep amounted to a constructive dividend is, at best, raw speculation. *See, e.g., Mills v. Internal Revenue Serv.*, 840 F.2d 229, 235 (4th Cir. 1988) (holding that payments between corporate entities are constructive dividends only if there is a direct benefit to the shareholder above and beyond its interest in the corporation). Moreover, from Gannett's description, its own cash management system, in which funds from various business units apparently are commingled, appears distinct from Petitioner's cash sweeps described in the record. Gannett Br. at 5 n.2. How Gannett's particular cash management system impacts its state-court litigation can thus only be imagined under its present account of the facts. In any case, Petitioner did not make this "constructive dividend" argument to the appellate court, or introduce any facts to prove it, and the argument should not be raised now by an *amicus*. *See McArthur*, 531 U.S. at 334-35 (arguments not made below are waived); *see also Container Corp.*, 463 U.S. at 164 (it is *taxpayer*'s burden to prove by clear and cogent evidence that extraterritorial values are being taxed).

Petitioner and *amicus*'s attempt to diminish the tax benefits Petitioner realized through its manipulation of Lexis/Nexis's business form is another improper post hoc attempt to reweigh the evidence. Pet. 14; COST Br. at 7. Petitioner was not using Lexis/Nexis simply for vague "tax advantages" but for the concrete benefit of claiming net loss carry forwards, which would otherwise expire. *Cf. In re Envirodyne Indus.*, 354 F.3d 646 (7th Cir. 2004) (Posner, J.) (rejecting taxpayer's attempt to unitize corporate subsidiaries through common parent in order to apply losses incurred by one line of subsidiaries to unrelated profitable subsidiaries).

In the end, Petitioner and *amici* are complaining about how the appellate court weighed the facts and applied the facts to the legal standard. *See, e.g.*, COST Br. at 4 ("It is the application of

this standard that should determine the outcome of this case."). Indeed, the heart of *amicus* COST's brief is devoted to reweighing the facts on which the appellate court relied. *See, e.g.*, COST Br. at 6-8 (noting that "[s]trategic planning about asset holdings . . . supports a conclusion" that the asset is an investment," and "100% ownership of a subsidiary . . . . may be for operational synergy; others serve strictly [as] an investment purchase."). Contesting how the state appellate court weighed the facts and applied the settled law to them does not create a conflict or inconsistency with this Court's decision in *Allied-Signal* or any other of this Court's decisions.[5] Further review by this Court is unwarranted.

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[5] *Amicus* COST's general complaint that the appellate court's reasoning will subject its members to multiple and discriminatory taxation on investments (*id.* at 2, 9) misses the mark. Whether income is subject to multiple or discriminatory taxation is a function of the fairness of the apportionment formula, not the fact of income apportionment. *See Container Corp.*, 463 U.S. at 169-71. States have wide latitude in their selection of apportionment formulas, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978), and the type of three-factor formula used by Illinois during the 1994 tax year, *see* 35 ILCS 5/304(a) (1994), is "something of a benchmark against which other apportionment formulas are judged," *Container Corp.*, 463 U.S. at 170. Moreover, while Petitioner did argue in the appellate court that the inclusion of Lexis/Nexis's gain in Illinois' apportionment formula unconstitutionally distorted the amount of income attributable to Illinois (*see* Pet. App. 17a-18a), it did not raise this contention in its Question Presented (*see* Pet. i).

## II. The Decision of the Intermediate Appellate Court in this Case Does Not Conflict with Decisions of Other States' High Courts.

Petitioner has not identified any direct conflict with other States' high court decisions. Like this Court in *Allied-Signal*, 504 U.S. at 785, other state courts have noted that the operational function test is fact-intensive, *see Alaska Dep't of Revenue v. OSG Bulk Ships, Inc.*, 961 P.2d 399, 413 (Alaska 1998); *see also Citicorp N. Am., Inc. v. Franchise Tax Bd., Inc.*, 100 Cal. Rptr. 2d 509, 532 (Ct. App. 2000) (taxpayer failed to produce evidence that out-of-state real estate rental income was unrelated to in-state business). And other state courts have applied criteria similar to those on which the Illinois Appellate Court relied.

In *Hoechst Celanese Corp. v. Franchise Tax Bd.*, 22 P.3d 324, 328-30 (Cal.), *cert. denied*, 534 U.S. 1040 (2001), the California Supreme Court found that a gain realized from the partial reversion of the taxpayer's pension trust fund was operational income, despite the fact that the taxpayer did not hold legal title to trust fund assets. The income was apportionable under the operational function test because the taxpayer funded the plan with apportionable business income, managed the plan by choosing its management and guiding its overall investment strategy, and because the plan made better use of the taxpayer's employees, a business-related resource. *See* 22 P.3d at 344-45. The *Hoechst Celanese* court thus relied on many of the same facts that the Illinois Appellate Court did—capital support, investment oversight and control—in reaching its conclusion that the trust fund was the taxpayer's operational asset. *See id.* at 345. There is no conflict between the present case and *Hoechst Celanese*, as Petitioner suggests. Pet. 21-22.

In *Citicorp N. Am.*, 100 Cal. Rptr. 2d at 531-32, the California Court of Appeal held that a banking and financial services conglomerate's gain from the sale of out-of-state office property that generated business income from rentals to unrelated third parties was constitutionally apportionable under the operational function test. The court noted that the taxpayer failed to produce evidence that its real estate holdings were divorced from its financial services business. *Id.* As in *Hoechst Celanese*, this Court denied the certiorari petition. *See Citicorp North Am., Inc. v. Franchise Tax Bd.*, 533 U.S. 963 (2001).

Like the rental income in *Citicorp N. Am.*, Lexis/Nexis's income contributed to and was treated as Petitioner's business income prior to its sale. And like the taxpayer in *Citicorp N. Am.*, Petitioner has not proven that Lexis/Nexis had nothing to do with Petitioner's activities in Illinois. These two cases do not conflict. *Cf. Jim Beam Brands Co. v. Franchise Tax Bd.*, 34 Cal. Rptr. 3d 874, 878-82 (Ct. App. 2005) (holding that gain realized from liquidating sale of subsidiary that contributed to production of business income was also apportionable business income under state law).

Nor does *OSG Bulk Ships* conflict with the present case, as Petitioner also contends. Pet. 21. That case did not involve the sale of a corporate asset. Rather, the parties stipulated that the income in question was investment income. The issue on appeal was whether that investment income could be apportioned if it did not contribute to working capital. The Alaska Supreme Court held that for investment income to be "operational" it had to contribute to working capital. 961 P.2d at 412-14. In short, that case involved the treatment of investment income specifically, and nothing in the decision foreclosed apportioning the gain from the sale of a business asset, as the Illinois Appellate Court did here.

*Pennzoil Co. v. Dep't of Revenue*, 33 P.3d 314, 318 (Or. 2001), *cert. denied*, 535 U.S. 927 (2002), also did not involve a capital transaction directly. There, the Oregon Supreme Court held that the State could tax a portion of an oil company's settlement proceeds from a lawsuit arising out of the failed acquisition of another oil company. The court held that because the target of the acquisition owned significant oil reserves, and those reserves were important to the taxpayer's in-state business, the proceeds qualified as operational income under the *Corn Products* doctrine, recognized by this Court in *Allied-Signal*, 504 U.S. at 788. But that case does not limit the operational function test to *Corn Products*-type fact-patterns, as Petitioner suggests. Pet. 21-22. In fact, the Oregon Supreme Court applied the *Corn Products* doctrine quite broadly, citing no evidence that potential oil reserves were necessary to supply the in-state motor-oil blending business.

Nor do the series of *Hercules* cases that Petitioner cites conflict with the present case. *See* Pet. 19-20 (citing *Hercules, Inc. v. Comptroller of Treasury*, 716 A.2d 276 (Md. 1998); *Hercules, Inc. v. Comm'r of Revenue*, 575 N.W.2d 111 (Minn. 1998)). As the Illinois Appellate Court's own *Hercules* decision illustrates, these decisions provide an appropriate counterpoint to the present case, for they applied many of the same factors that the Illinois Appellate Court applied here. *See Hercules v. Dep't of Revenue*, 753 N.E.2d 418 (Ill. App. Ct. 2001).

In *Hercules*, the taxpayer spun off a former division into an independent joint-venture company—one in which the taxpayer did not hold a majority interest, that it could not control, had no operational ties to, and dealt with at arm's length. 753 N.E.2d at 426-28. Not only did the Minnesota and Maryland high courts agree that under this set of facts the State could not apportion the gain from the sale of the business asset, *Hercules, Inc.* 575 N.W.2d at 116-17; *Hercules, Inc.*, 716 A.2d at 112-15, but so did

the Illinois Appellate Court, 753 N.E.2d at 430. The instant case does not conflict with these decisions. It is the result of applying the same legal standard to a different set of facts.

This Court has accorded great flexibility to the States in deciding the question of the constitutional apportionability of income. The taxpayer's burden to show that its constitutional rights were infringed "*is never met merely by showing a fair difference of opinion*," and this Court will not "re-examine, as a court of first instance, findings of fact supported by substantial evidence." *Container Corp.*, 463 U.S. at 175-76 (emphasis in original). As a result, this Court expects that different factual circumstances will lead to different results. *Allied-Signal*, 504 U.S. at 785.

As the above discussion of the case law illustrates, this Court's expectation has been realized. The Illinois Appellate Court and other state courts have ably applied *Allied-Signal* and reached different results in different factual circumstances. In applying the *Allied-Signal* standard, the Illinois Appellate Court and other state courts have correctly examined the "objective characteristics of the income-producing asset's use and its relation to the taxpayer and its activities in the taxing state," *Hoechst Celanese*, 22 P. 2d at 345 (quoting *Allied-Signal*, 504 U.S. at 785) (punctuation omitted); (Pet. App. 11a), to determine whether the necessary "minimum connection exists between the taxing state and the corporation's business activities," (Pet. App. 10a) (citing *Allied-Signal*, 504 U.S. at 772), or whether the income instead was earned in the course of unrelated activities, *see Pennzoil*, 33 P.3d at 318 (citing *Allied-Signal*, 504 U.S. at 787).

In the end, all that Petitioner and *amici* can muster is a complaint that in this case the appellate court did not properly weigh the evidence and misapplied that evidence to this Court's

legal standard. But such a contention does not mean that the appellate court's decision cuts loose the apportionment principles from any limitations. *See* COST Br. at 5. And a disagreement with the Illinois Appellate Court's application of the facts to the law does not provide a basis for this Court's review.

## CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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